Chapter – X : Mergers and Acquisitions

1. A business may grow over time as the utility of its products and services is recognized. It may also grow through an inorganic process, symbolized by an instantaneous expansion in work force, customers, infrastructure resources and thereby an overall increase in the revenues and profits of the entity. Mergers and acquisitions are manifestations of an inorganic growth process. While mergers can be defined to mean unification of two players into a single entity, acquisitions are situations where one player buys out the other to combine the bought entity with itself. It may be in form of a purchase, where one business buys another or a management buy out, where the management buys the business from its owners. Further, de-mergers, i.e., division of a single entity into two or more entities also require being recognized and treated on par with mergers and acquisitions regime as recommended below, and accordingly references below to mergers and acquisitions also is intended to cover de-mergers (with the law & Rules as framed duly catering to the same).

2. Mergers and acquisitions are used as instruments of momentous growth and are increasingly getting accepted by Indian businesses as critical tool of business strategy. They are widely used in a wide array of fields such as information technology, telecommunications, and business process outsourcing as well as in traditional business to gain strength, expand the customer base, cut competition or enter into a new market or product segment. Mergers and acquisitions may be undertaken to access the market through an established brand, to get a market share, to eliminate competition, to reduce tax liabilities or to acquire competence
3. The process of mergers and acquisitions in India is court driven, long drawn and hence problematic. The process may be initiated through common agreements between the two parties, but that is not sufficient to provide a legal cover to it. The sanction of the High Court is required for bringing it into effect. The Companies Act, 1956 consolidates provisions relating to mergers and acquisitions and other related issues of compromises, arrangements and reconstructions, however other provisions of the Companies Act get attracted at different times and in each case of merger and acquisition and the procedure remains far from simple. The Central Government has a role to play in this process and it acts through an Official Liquidator (OL) or the Regional Director of the Ministry of Company Affairs. The entire process has to be to the satisfaction of the Court. This sometimes results in delays.

4. Needless to say, in the context of increasing competitiveness in the market, speed is of the essence, especially in an expanding and vibrant economy like ours. A sign of corporate readiness, skill and stratagem is the ability to do such mergers and acquisitions with ‘digital’ speed. E-governance could provide a helpful tool in achieving the objective of speed with provisions for online registration, approvals etc.

5. The Committee was of the view that contractual mergers may be given statutory recognition in the Company Law in India as is the practice in many other countries. Such mergers and acquisitions through contract form (i.e. without court intervention), could be made subject to subsequent approval of shareholders by ordinary majority. This would eliminate obstructions to mergers and acquisitions, ex-post facto protection and ability to rectify would be available.

6. There has been a steady increase in cross-border mergers with the increase in global trade. Such mergers and acquisitions can bring long-
term benefits when they are accompanied by policies to facilitate competition and improved corporate governance.

7. The Committee went into several aspects of the provisions in the existing law constituting a separate code in themselves and regulating a very important aspect of restructuring and consolidation of business in response to the economic environment. An effort was made to identify the areas of concern under the present law and to recommend means of addressing them.

8. At present, in case of a proposed scheme for amalgamation of company which is being dissolved without winding up, the law requires a report from the Official Liquidator (OL) or Registrar of Companies (ROC) that the affairs of company have not been conducted in a manner prejudicial to the interest of its members or to public interest. The Act also requires that no order for dissolution of any transferor company shall be made by the Court unless the OL makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest. The Committee felt that the above two requirements under the present law can be covered by issuing notices to ROC and OL respectively; who may file before the Court, information that may have a bearing on the proposed merger. There is no requirement of a separate information in response to the notice to be filed for the purpose. Filing of such report may be time-bound, beyond which it may be presumed that ROC/OL concerned have no comments to offer.

**Single window concept:**

9. The law should provide for a single forum which would approve the scheme of mergers and acquisition in an effective time bound manner. The law should also provide for mandatory intimation to regulators in respect of specified class of companies. The concept of ‘deemed approval’ should be provided for in cases where the regulators do not intimate/inform their comments within a specified time period to the
Court/Tribunal before which the scheme of merger/amalgamation is submitted for approval.

Valuation of shares:

10. The Committee while discussing this aspect in detail, also took into account the Shroff Committee Report on “Valuation of Corporate Assets and Shares” during the course of its deliberation on the subject and took the view that valuation of the shares of companies involved in schemes of mergers should be made mandatory in respect of such companies. It was also recommended that such valuation should be carried out by independent registered valuers rather than by Court appointed valuers. The law should lay out the exception, if any, to the mandatory valuation requirements. The law should also recognize valuation of incorporeal property. Valuation standards may also be developed on the lines of ‘International Valuation Standards’ issued by the International Valuation Standards Committee. The valuation should be transparent so that the aggrieved person may get an opportunity to challenge the same before Court/Tribunal. Benchmarking of valuation techniques and Peer Review Mechanism for Valuers should also be provided for.

11. Where an Audit Committee is mandatory for a company, the task of appointing the valuer should be entrusted to the Audit Committee. The Audit Committee should also have the duty to verify whether the valuer has an advisory mandate and had past association with the company management. The Audit Committee should verify the independence of the valuer for the purposes of an independent valuation. In the case of companies not required to have Audit Committee, this task should be carried out by the Board.

Registration of Merger and Acquisition:

12. The Committee discussed with concern, the differential stamp duty regime prevalent in different States, which inhibits merger and acquisition activity. It has been a question for consideration whether an
order of a court sanctioning a compromise/arrangement under Sections 391-394 of the Companies Act, 1956 would be stampable as a “conveyance” at the rates applicable to such entry in the various state Stamp Acts. Certain states like Maharashtra, Gujarat, Karnataka and Rajasthan sought to address this problem by amending their stamp legislations to make an order of the High Court under Sections 391-394 stampable. However, majority of the states in India have not adopted this stand, resulting in a confusion on the issue. This confusion is more acutely present in the case of mergers of companies that have registered offices in different states. However, as this subject falls within the domain of the States under the Constitution, the States will have to take initiative in this regard. It would be appropriate for the Central Government to facilitate a dialogue in this regard.

13. The Concept Paper on Company Law (2004) contemplates that an order of the scheme of merger will be effective only if a certified copy of the order of the Court is filed with the Registrar and duly registered. The Committee felt that it should be enough if the company complies with the filing requirement with the Registrar of Companies as is presently provided, to make the scheme effective.

14. The Committee also felt that a separate electronic registry should be constituted for filing schemes under Sections 391/394 of the Companies Act. Instead of filing the schemes with the Registration Offices wherever the properties of the company are located, filing the scheme with the electronic registry should be considered sufficient compliance. This however, could raise jurisdictional issues vis-à-vis Stamp Duties applicable which may be resolved by an appropriate Constitutional amendment to enable a uniform, reasonably priced Stamp Duty regime across the country. Further, there must also be a provision in the Company Law for compulsory registration with the electronic registry of all property of a company above a certain value. This will simplify the mutation procedure subsequent to scheme of arrangement between
two or more companies. The Committee took the view that enabling uniformity and overall reduction of Stamp Duties applicable in pursuance of mergers, demergers, amalgamations or schemes of reconstruction, takeover would be desirable as competition requires cost reduction and Indian firms need to be competitive in restructuring exercise in the global context.

**Merger of a listed company into an unlisted company and vice-versa:**

15. The Committee examined issues relating to the merger of listed company with an unlisted company and vice-versa. It was felt that the Act needs to provide specifically that de-listing through a scheme of merger under section 391-394 of the Companies Act is possible by merging a listed company with an unlisted company. However, such a process should enable a safety net or a clear exit option for the public shareholders of the listed company. Similarly, if substantial assets are moved out of a listed company in the case of de-merger, a safety net/exit option needs to be provided to the public shareholders and the residual company needs to be de-listed (in case more than 90% of the public shareholders exercise such option).

16. The law should enable companies to purchase the stake of minority shareholders in order to prevent exploitation of such shareholders where a promoter has bought back more than 90% of the equity. Such purchase should, however, on the basis of a fair offer. Appropriate valuation rules for this purpose should be prescribed, or, the last known price prior to delisting, could be made the benchmark for such acquisitions.

**Approval of the Scheme:**

17. The existing Law requires that a scheme for merger and/or any arrangement should be approved by a majority in number representing also 3/4th in value of shareholders/creditors present and voting. The requirement of majority in number does not serve any useful purpose considering that value is simultaneously being considered as a criterion.
Besides, international practice recognizes value as the determining factor and does not appear to impose such additional conditions. The Committee is, therefore, of the view that this requirement, in Indian law, may also be modified to provide only for approval by 3/4th in value of shareholders and creditors, present and voting.

18. Under the present scheme of Act, the manner of holding of the meetings of the creditors and shareholders as also dispensing with the same is left to the discretion of the courts. However, different courts follow different procedures. The Committee feels that there is a need for uniformity in this regard and recommends that rules may be formulated under the Act to cover this aspect, including dispensing of the requirement to hold such meetings.

**Minority Interest:**

19. The Committee examined the view that quite frequently shareholders/creditors with insignificant stake raise objections to schemes of merger/acquisition and the process of dealing with such objection becomes vexatious. After a detailed discussion, the Committee recommended that while protection of minority interest should be recognized under the law, only shareholders/creditors having significant stake at a level to be prescribed under law should have the right to object to any scheme of mergers. The philosophy behind such a move would be to streamline the procedure of articulation of the minority interest while restricting obstructionist attitude on the part of any section of minority.

**Merger of class of companies:**

20. The Committee reviewed the international models of mergers and amalgamations. In the case of mergers within a group, the Act may prescribe a short form of amalgamation. Conceptually a scheme of amalgamation or merger between holding company and subsidiary company stands on a different footing from amalgamation and merger.
between two independent companies. So also merger between two private limited companies should be viewed differently as compared to the merger of two public limited companies. The amended new Act should provide for less regulation in respect of mergers among associate companies/two private limited companies where no public interest is involved. The concept of contractual merger should also be thought of as an alternative to the form of merger available under the Act as on date.

**Cross Border Mergers:**

21. A forward looking law on mergers and amalgamations needs to also recognize that an Indian company ought to be permitted with a foreign company to merger. Both contract based mergers between an Indian company and a foreign company and court based mergers between such entities where the foreign company is the transferee, needs to be recognized in Indian Law. The Committee recognizes that this would require some pioneering work between various jurisdictions in which such mergers and acquisitions are being executed/created.

22. The Indian shareholders should be permitted to receive Indian Depository Receipts (IDR) in lieu of Indian shares especially in listed companies or foreign securities in lieu of Indian shares so that they become members of the foreign company or holders of security with a trading right in India (especially in listed companies). Further, in such cases, the shell of such company should be allowed to be dissolved without winding up with court intervention. The present Act does not permit this form of merger in view of the specific definition of company under section 390(a) of the Companies Act. The Committee noted that apart from amendments to the Companies Act, suitable changes may be necessary in the Income Tax Act, Foreign Exchange Management Act and provisions relating to IDR to enable merger of an Indian Company with foreign entity. The Committee therefore recommended adoption of
international best practices and a coordinated approach while bringing amendments to the code of merger in the Companies Act.

Disclosure Requirements:

23. As the shareholders need to have complete information in the case of a scheme of merger/acquisition, specially in the case of promoter initiated mergers, the Act/Rules should list out the disclosure requirements in the explanatory statements to be sent to the shareholders in respect of the scheme filed before the Courts/Tribunals. In the case of Companies required to appoint independent directors, the Act should mandate the Committee of independent directors as a monitoring body to ensure adequacy of disclosures.

Other Matters:

Corporate Restructuring:

24. The Reserve Bank of India has specific tools for fast track debt restructuring known as the CDR Mechanism (Corporate Debt Restructuring Mechanism). It is often seen that sometimes even though 75% of the secured creditors consent to the debt restructuring and make significant sacrifices, minority secured creditors or unsecured creditors put a spoke through the wheel. As a result, such schemes that would otherwise enable the return of the corporate to viable operation, get delayed or scuttled.

25. As in the case of contractual mergers or schemes of arrangement, the Committee recommends that if the petitioning creditors or petitioning company is prima facie able to prove that 75% of the secured creditors who have consented to the CDR Mechanism have made sacrifices to restructure the company then, notwithstanding the minority dissent, such a scheme should be sanctioned on filing.

26. Appropriate remedies for misstatement and the ability to revoke such an order with punishment for any misstatement would be an adequate safeguard for false misstatement. The unsecured creditors are
subsequent in the queue and without the consent of the secured creditors and their debt restructuring, they would have no hope to receive their dues. However, to safeguard their interests and to ensure the continuity of the company’s functioning, the scheme must satisfy a minimum liquidity test and should have provisions for a security pool either made available by the secured creditor as cash availability or by the promoter to progress the scheme of restructuring.

27. Such schemes must contain safeguards against fraudulent preference and must have a creditors’ responsibility statement, similar to a directors’ responsibility statement, appended to it. Withdrawal from the security pool provided for by the liquidity test could be regulated by the Court/National Company Law Tribunal.

28. The Committee recommended that the need to file a separate scheme for reduction of capital simultaneously the scheme for merger and acquisition should be avoided. The provisions relating to obtaining consent from unsecured creditors should be done away with. To ensure continuity of the existence of transferee company/resulting company, the Committee felt the need to mandate requirement of a satisfactory liquidity test and prescribed debt equity norms. The creditors consent may be necessary only in case of companies not meeting the liquidity test.

Amalgamation in Public Interest:

29. Existing Section 396 empowers Central Government to order amalgamation of two or more companies in public interest. It has been suggested that these provisions should be reviewed. It is felt that amalgamation should be allowed only through a process overseen by the Courts/Tribunals. Therefore, instead of existing provisions of Section 396, provision should be made to empower Central Government to approach the Court/Tribunal for approval for amalgamation of two or more companies.
Fees on increased Authorized Share capital:

30. At any point of time the transferor company and the transferee company, both companies would have paid fees of their respective authorized share capital at the rates specified in Schedule X of the Companies Act, 1956. Upon dissolution of the transferor company into the transferee company, the fees paid by the transferor company go waste and the transferee company gets no set off for the same.

31. In order to facilitate and encourage merger and acquisition activities, it is recommended that the fees paid by the transferor company on the authorized share capital should be available as a set off to the transferee company upon the sanction of the scheme of amalgamation by the High Court. This principle should apply both in respect of merger and demerger cases.

Introduction of Non-obstante Clause in sec. 394(2):

32. Section 394(2) of the Companies Act, 1956 provides for vesting of assets and liabilities of the transferor company in the transferee company upon the sanction of the scheme of amalgamation by the High Court. Since the section does not contain a non-obstante clause, it creates immense practical difficulties in actual transfer of the various properties/assets of the transferor company into the transferee company.

33. It was noted that the Sick Industrial Companies (Special Provisions) Act, 1985 and Section 32 thereof had clear provisions in the nature of a non-obstante declaratory order whilst sanctioning a scheme of restructuring. The Sick Industrial Companies Act has been subsumed in the company law and the principles therein, therefore, are eminently capable of being modified and applied in the new company law to be made.

34. It is therefore recommended that a non-obstante provision be introduced in the relevant provisions of the law to ensure that the assets and liabilities of the transferor company absolutely vest in the transferee company notwithstanding anything to the contrary in any other law for
the time being in force. This would ensure that the transferee company is not subjected to cumbersome formalities for the transfer of assets and liabilities in its own name.